

February 2024

A Time for Sentiment

Toby Warburton

Global Head of Portfolio Management
Systematic Equity — Active

Sentiment, one of the core four themes within our investment return model, delivered stunning performance in January. The factor generated its strongest monthly return since the height of the COVID disruptions in mid-2020. This month we dig deeper into the Sentiment factor, and its close cousin Momentum, to better understand what is driving returns and to assess comparative periods of extreme performance.

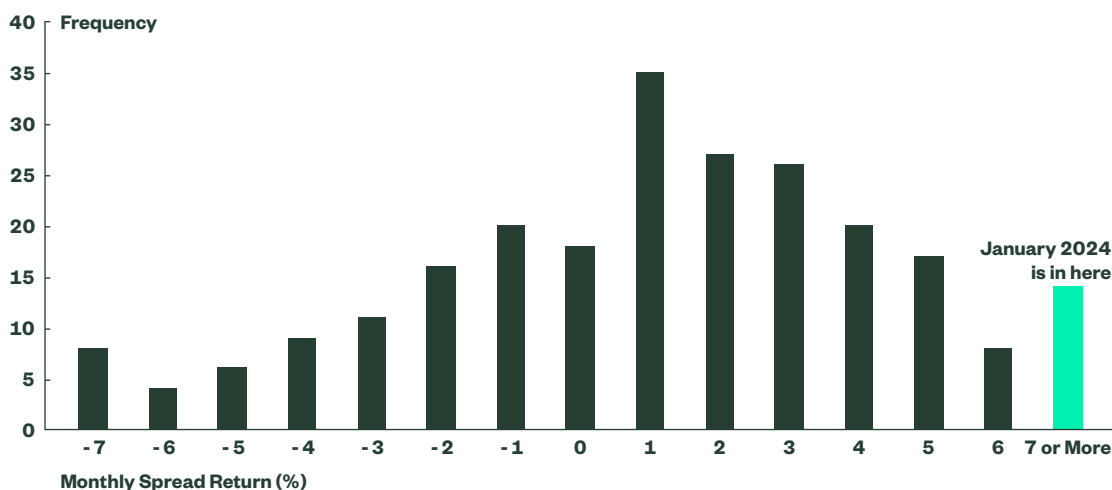
Sentiment in January and Over the Long Term

The Systematic Equity – Active (SE-A) team has four core themes that we deploy in our proprietary ‘alpha’ model that we use to systematically assess future return expectations for approximately 19,000 stocks on a daily basis. The four themes we analyze consistently are: Sentiment, Value, Quality, and Catalyst.

The SE-A Sentiment theme pulls together direct and indirect measures that capture the evolution of companies’ operating environments and the market’s appreciation of them. As such, it is reflective of both the broader macroeconomic and investment environment, as well as of corporate idiosyncrasies that drive returns for stocks.

Sentiment delivered an outsized spread return¹ in January of 7% in our Large Cap Developed Market universe, buoying active performance across our suite of strategies. Although not an all-time high, January’s return was still significantly larger than average. Our Sentiment theme is considerably more nuanced and refined than a traditional Price Momentum factor as it is designed for capturing alpha, rather than as broad factor exposure. Though different, the two factors do share some parallel characteristics. Similar to Sentiment, the Momentum factor’s high positive spread return in January also falls in the tails of the distribution.

Figure 1
**Frequency Distribution
of Monthly Returns
for Medium-Term
Momentum Factor**



Source: State Street Global Advisors, FactSet, Axioma. Data as of January 31, 2024.

Sentiment Exposure in Extremes

Prior peaks in Sentiment performance came in July 2020, November 2011, and in 2008 during the buildup of the Global Financial Crisis (GFC). By contrast, the weakest performance came in March and April 2009 as investors saw a way out of the GFC and in November 2020 as the surprising efficacy of COVID vaccines paved a path out of the COVID crisis.

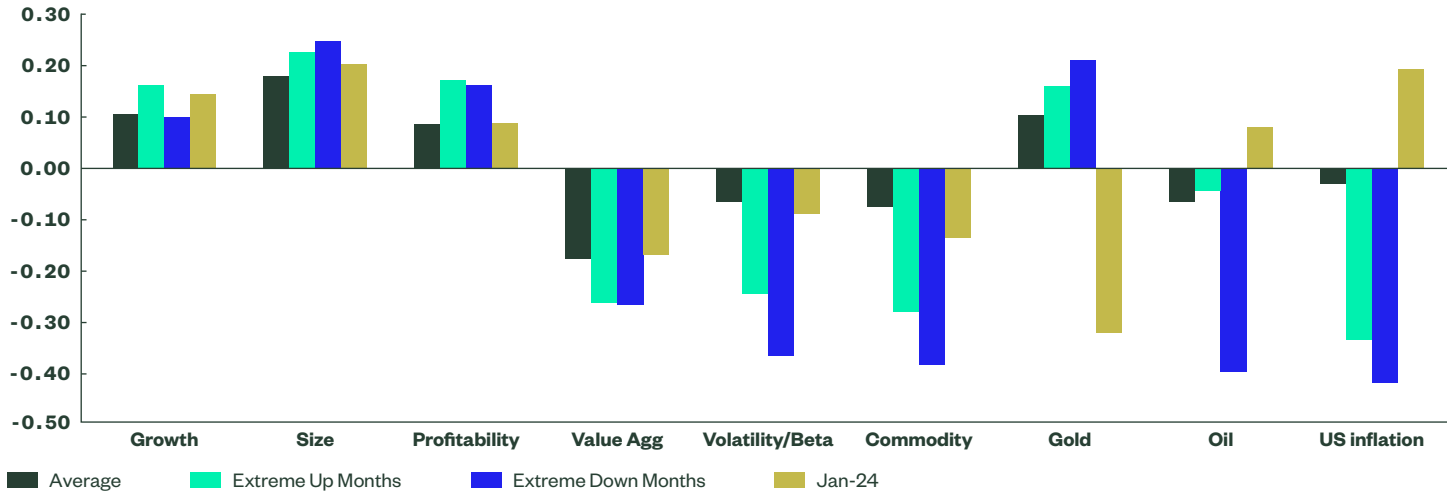
As Sentiment and Momentum latch on to prevailing market themes their exposures to other themes and risk factors, particularly in extreme periods, provide insights into what is driving markets at a given time.

To test our hypothesis, we analyzed the 10 most extreme positive months and the 10 most extreme negative months for Momentum returns over the past 20 years. In those periods, we compared average factor correlations with the 20-year average correlations and the observation for January. We were careful not to confuse causation and correlation, and therefore we observe:

- Across many risk factors, exposures are not significantly different between extreme months and the long-term averages.
- Extreme months tend to have a slightly more negative exposure to Valuation (i.e. Momentum points to more expensive names).
- Momentum in extreme months has tended to show significant bias towards low risk names; January, by contrast, trended toward the long-term average.
- Commodity exposures have also appeared stretched in other extreme months. January appears to show a notable deviation from these other periods, especially in oil and gold exposures.
- In prior extreme periods, Momentum has tilted towards areas of the market that benefit from disinflation. In January, for example, it had a positive tilt towards US inflation, presumably as the inflationary spike of last year was still working its way out of the factor.
- In general, Momentum crash months tend to have more exaggerated exposure to risk factors than in other periods, while January looked closer to the long-term average.

Figure 2

Correlation of Momentum with Selected Risk Factors



Source: State Street Global Advisors, FactSet, Axioma. Data as of January 31, 2024.

Finally, we looked at the average three-month spread return for Momentum following an extreme up or down month. For extreme positive months, the factor gave back a little of the strong returns, delivering -1.1% over the next three months. For extreme negative returns, the average subsequent three months returned -6.6%, a figure heavily skewed by returns in February and March 2009 amid the significant rotation from the GFC. If we ignore that period, the average would be -1.9%, not dissimilar to the positive months.

The Bottom Line

Momentum and Sentiment factors performed very strongly in January, but not anomalously so. Digging into exposures of Momentum to other risk factors, we determine that January’s results in many ways look more similar to the long-term average as compared to other extreme performance months. We also find that extreme one-month performance tends not to repeat itself over the subsequent three months.

While Momentum and Sentiment share some similarities, we explicitly use our diversified, nuanced Sentiment measure in our investment process. The additional diversification in our measure helps mitigate the effects of some of the extreme returns, particularly on the downside. In the 10 most extreme negative months for Momentum over the past 20 years, the Momentum factor generated returns of -12.4% on average, while our Sentiment measure fell -8.4%.

By combining Sentiment measures with other themes, such as Value, Quality, and Catalyst signals, we can strengthen portfolio returns with diversification, thereby limiting the effects of extreme short-term returns while still benefitting from the strong, long-term performance of Sentiment.

Endnote

1 The difference in median return between stocks in the top quintile of distribution of the factor compared to those in the lowest quintile, within the Systematic Equity — Active Developed Market Core universe.

About State Street Global Advisors

Our clients are the world's governments, institutions and financial advisors. To help them achieve their financial goals we live our guiding principles each and every day:

- Start with rigor
- Build from breadth
- Invest as stewards
- Invent the future

For four decades, these principles have helped us be the quiet power in a tumultuous investing world. Helping millions of people secure their financial futures. This takes each of our employees in 29 offices around the world, and a firm-wide conviction that we can always do it better. As a result, we are the world's fourth-largest asset manager* with US \$4.13 trillion[†] under our care.

* Pensions & Investments Research Center, as of December 31, 2022.

[†] This figure is presented as of December 31, 2023 and includes approximately \$64.44 billion USD of assets with respect to SPDR products for which State Street Global Advisors Funds Distributors, LLC (SSGA FD) acts solely as the marketing agent. SSGA FD and State Street Global Advisors are affiliated.

ssga.com

Marketing communication.

[State Street Global Advisors
Worldwide Entities](#)

For use in EMEA: The information contained in this communication is not a research recommendation or 'investment research' and is classified as a 'Marketing Communication' in accordance with the Markets in Financial Instruments Directive (2014/65/EU) or applicable Swiss regulation. This means that this marketing communication (a) has not been prepared in accordance with legal requirements designed to promote the independence of investment research (b) is not subject to any prohibition on dealing ahead of the dissemination of investment research.

This communication is directed at professional clients (this includes eligible counterparties as defined by the appropriate EU regulator) who are deemed both knowledgeable and experienced in matters relating to investments. The products and services to which this communication relates are only available to such persons, and persons of any other description (including retail clients) should not rely on this communication.

Important Risk Information

The information provided does not constitute investment advice and it should not be relied on as such. It should not be considered solicitation to buy or an offer to sell a security. It does not take into account any investor's particular investment objectives, strategies, tax status or investment horizon. You should consult your tax and financial advisor.

All information is from State Street Global Advisors unless otherwise noted and has been obtained from sources believed to be reliable, but its accuracy is not guaranteed. There is no representation or warranty as to the current accuracy, reliability or completeness of, nor liability for, decisions based on such information and it should not be relied on as such.

This document contains certain statements that may be deemed forward-looking statements. Please note that any such statements are not guarantees of any future performance and actual results or developments may differ materially from those projected. Investing involves risk including the risk of loss of principal.

The views expressed are the views of Systematic Equity – Active through February 15, 2024, and are subject to change based on market and other conditions.

Quantitative investing assumes that future performance of a security relative to other securities may be predicted based on historical economic and financial factors, however, any errors in a model used might not be detected until the fund has sustained a loss or reduced performance related to such errors.

Equity securities may fluctuate in value and can decline significantly in response to the activities of individual companies and general market and economic conditions.

© 2024 State Street Corporation.
All Rights Reserved.
ID2024162-5806250.71.GBL.RTL 0224
Exp. Date: 02/28/2025